

# **WEST VIRGINIA SECURITIES COMMISSION**

## **STATEMENT OF POLICY**

### **Promotional Shares**

**June 28, 2010**

This Statement of Policy is adopted by the West Virginia Securities Commission pursuant to the authority of the Securities Commissioner of the State of West Virginia granted under Chapter 32 of the West Virginia Code. The West Virginia Securities Commissioner has determined that the following Statement of Policy relating to promotional shares is consistent with public investor protection and is in the public interest. The Commissioner may waive any requirement of this Statement of Policy for good cause, as he may determine.

#### **I. APPLICATION**

This statement of policy applies to all applications to register by coordination or by qualification.

#### **II. DEFINITIONS**

The terms used in this Statement of Policy are defined pursuant to the West Virginia Securities Commission Statement of Policy regarding Corporate Securities Definitions unless specifically stated otherwise within this Statement of Policy, or when the context clearly indicates otherwise.

#### **III. ESCROW OF PROMOTIONAL SHARES**

As a condition to registering a public offering of equity securities, the Commissioner may require that some or all of the promoters deposit promotional shares into an escrow account ("escrow") with an escrow agent, as provided by an escrow agreement. Promoters who deposit promotional shares into escrow will be collectively referred to as "depositors".

- A.** The number of promotional shares required for deposit in escrow shall be calculated according to the following

formula, except in situations where a promoter must comply with section III-B below:

$$a - b$$

where

$a$  equals total number of shares that the promoters hold

$b$  equals the number of fully paid shares, calculated as follows:

$$\frac{c}{d \times 0.85}$$

$c$  equals the total that the promoters paid for the shares, and

$d$  equals the public offering price per share

- B.** If the issuer's latest audited financial statements contain an auditor's report or footnote that contains an opinion or statement regarding the ability of the issuer to continue as a going concern, the promoters shall deposit all promotional shares in escrow.
- C.** In the case of multiple promoters, the Commissioner may require each promoter to deposit promotional shares into escrow on a pro rata basis.

#### **IV. RELEASE OF PROMOTIONAL SHARES**

- A.** The escrow agent shall release the promotional shares held in escrow in the manner set out in the table below:

If the issuer's aggregate revenues are:

- a.** \$500,000 or more (class A offering), and neither the auditor's opinion nor any footnote to the issuer's latest audited financial statements contain an opinion or statement regarding the ability of the issuer to continue as a going concern, then the required release of escrow or lock-in shares are as follows:

- i. Year 1 – none
- ii. Year 2 – 2 ½% pro rata per quarter
- iii. Year 3 – all

b. Less than \$500,000 (class B offering), then the required release of escrow or lock-in shares are as follows:

- i. Year 1 – none
- ii. Year 2 – none
- iii. Year 3 – 2 ½% pro rata per quarter
- iv. Year 4 – 2 ½% pro rata per quarter
- v. Year 5 – all

- B.** In the event securities in the escrow become "Covered Securities," as defined in Section 18(b)(1) of the Securities Act of 1933, the escrow agent shall release all securities in escrow.
- C.** If the public offering is terminated, and no securities were sold, the escrow agent shall release all securities in escrow.
- D.** If the public offering is terminated, and all of the gross proceeds of the offering have been returned to the public investors, the escrow agent shall release all securities in escrow.

## **V. DISTRIBUTION OF THE ISSUER'S ASSETS OR SECURITIES**

The depositors agree that if any transaction or proceeding results in a distribution of the issuer's assets or securities ("distribution"), while the agreement remains in effect, one of the following happens:

- A.** If the transaction is with a person that is not a promoter:
  - 1.** Holders of the issuer's equity securities initially share in the distribution on a pro rata basis, depending on the price the holders paid per share. This continues until the public shareholders are paid out in full. For the purpose of this Statement of Policy, the public shareholders are paid out in full when they have

received, or have had irrevocably set aside for them, an amount equal to:

$$A \times B \times 100\%$$

where *A* equals price per share in the public offering, and where *B* equals the number of shares they purchased under the public offering and still hold at the time of the distribution.

2. Once the public shareholders are paid out under section V-A-1, holders of the issuer's equity securities participate on a pro rata basis, depending on the number of shares of equity securities they hold at the time of the distribution.
3. A distribution may proceed on lesser terms and conditions than those stated in sections V-A-1 and 2, if the holders of a majority of the equity securities, not including related party securities, approve the lesser terms and conditions at a special meeting called for that specific purpose. For the purpose of this subparagraph, "related party securities" mean those promoters or their associates or affiliates.
4. The number of shares calculated for distribution under sections V-A- 1 and 2 may be adjusted if there is a stock split, stock dividend, recapitalization or similar transaction.

- B. If the transaction is with a promoter, the depositors' promotional shares shall remain in escrow subject to the terms of the agreement.

## **VI. DOCUMENTATION REGARDING THE TERMINATION OF THE ESCROW AGREEMENT AND/OR THE RELEASE OF PROMOTIONAL SHARES**

- A. A request for the release of any of the promotional shares from escrow shall be in writing and forwarded to the escrow agent.

- B.** The issuer shall provide the documentation, showing that the requirements of section IV, above, have been met to the escrow agent.
- C.** The escrow agent shall terminate the agreement and/or release some or all of the promotional shares from escrow if all the applicable provisions of the agreement have been satisfied. The escrow agent shall maintain all records relating to the agreement for a period of three (3) years following the termination of the agreement.
- D.** The escrow agent shall forward copies of all retained records to the Commissioner promptly upon written request.

#### **VII. NON-EXCLUSIVE RESTRICTIONS ON THE TRANSFER, SALE OR DISPOSAL OF PROMOTIONAL SHARES**

- A.** A depositor shall not transfer any promotional shares held in escrow or any interest in the promotional shares in escrow.
- B.** Despite subsection VII-A, a depositor may transfer promotional shares held in escrow by gift to the depositor's family members, if the depositor's family member agrees that the promotional shares remain subject to the terms of the escrow agreement.
- C.** For a self-underwritten offering, promoters shall not sell any of their promotional shares during the time that the issuer is offering its securities to the public, even if the promotional shares are not subject to escrow or would otherwise be released from escrow.

#### **VIII. TERMS OF THE ESCROW**

A summary of the agreement shall be included in the prospectus annual reports to shareholders, proxy statements and other disclosure materials used to make investment decisions until the public offering ends.

Glen B. Gainer, III  
State Auditor  
Commissioner of Securities

By: Lisa A. Hopkins  
General Counsel  
Senior Deputy Commissioner of Securities

June 28, 2010